

Initial Statement of Reasons for
Proposed Amendments to California Code of Regulations,
Title 18, Section 1603, *Taxable Sales of Food Products*

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFIT

Current Law

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (Rev. & Tax. Code, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (Rev. & Tax. Code, §§ 6012, 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers.

Civil Code section 1656.1 provides that whether a retailer may add sales tax reimbursement to the sales price of the tangible personal property sold at retail to a purchaser depends solely upon the terms of the agreement of sale. The sales tax reimbursement may be shown as a separately stated amount added to the separately stated sales price of the tangible personal property or the sales tax reimbursement may be included in the total lump-sum price charged for tangible personal property. Under Civil Code section 1656.1, it shall be presumed that the parties agreed to the addition of sales tax reimbursement to the sales price of tangible personal property if the retailer posts in his or her premises in a location visible to purchasers, or includes on a price tag or in an advertisement or other printed material directed to purchasers, a notice to the effect that reimbursement for sales tax will be added to the sales price of all items or certain items, whichever is applicable. California Code of Regulations, title 18, section (Regulation) 1700, generally provides that:

It shall be presumed that the property, the gross receipts from the sale of which is subject to the sales tax, is sold at a price which includes tax reimbursement if the retailer posts in his or her premises, or includes on a price tag or in an advertisement (whichever is applicable) one of the following notices:

1. "All prices of taxable items include sales tax reimbursement computed to the nearest mill."
2. "The price of this item includes sales tax reimbursement computed to the nearest mill."

Prior to 2001, Regulation 1574, *Vending Machine Operators*, also specifically provided that sales made through vending machines would be regarded as having been made on a tax-included basis if the vending machine operator posted a sign on or near the vending machine providing that "all prices of taxable items include sales tax reimbursement" As relevant here, in 2001, Regulation 1574 was amended to delete the requirement that vending machine operators post a

sign providing that their sales are made on a tax-included basis and to instead provide that “[s]ales of tangible personal property through vending machines are presumed to be made on a tax-included basis,” notwithstanding the fact that the signage discussed in Civil Code section 1656.1 is not present. The 2001 amendments were based on the nature of the vending machine industry and the expectation from customers purchasing items through vending machines that all taxable sales are made on a tax-included basis.

Proposed Amendments

Mobile food vendors who sell food for immediate consumption from motorized vehicles, such as food trucks, or un-motorized carts, such as hot dog carts, do not generally have point of sale systems to calculate tax on individual transactions. Additionally, they often make sales in multiple tax districts in a given day and, as a result, their sales are often subject to varying tax rates. Therefore, similar to vending machine operators whose sales are discussed in Regulation 1574, it is common practice in the mobile food industry for mobile food vendors to make sales on a tax-included basis. It is common practice in the mobile food industry for mobile food vendors to round their tax-included prices to the nearest quarter or dollar. And, similar to the retailers and customers in the vending machine industry, mobile food vendors intend for the prices charged for the meals that they sell to include all applicable taxes, and their customers expect that amounts for sales tax reimbursement are included in the prices charged by the mobile food vendors.

In addition, while the mobile food industry practice is for mobile food vendors to include tax reimbursement in their menu prices, during recent audits, Board staff found that many mobile food vendors did not have a sign posted stating that tax reimbursement was included in their menu prices.

Interested Parties Process

The Board’s Business Taxes Committee (BTC) staff prepared draft amendments adding a new subdivision (u) to Regulation 1603, *Taxable Sales of Food Products*, to address the mobile food vendors’ signage issue (or problem within the meaning of Gov. Code, § 11346.2, subdivision (b)). The draft amendments suggested adding provisions to the regulation generally describes “mobile food vendors” by providing that mobile food vendors include retailers who sell food and beverages for immediate consumption from motorized vehicles or un-motorized carts. The draft amendments provided that such vendors include vendors operating food trucks, coffee carts, and hot dog carts. The draft amendments also provided that effective July 1, 2014, sales by mobile food vendors are presumed to be made on a tax-included basis unless a separate amount for tax reimbursement is added to the price. And, the draft amendments provided that this presumption does not apply when a mobile food vendor is making sales as a “caterer” as defined in subdivision (h)(1) of Regulation 1603.

BTC staff subsequently provided its draft amendments to Regulation 1603 to the interested parties and conducted an interested parties meeting in August 2013 to discuss the draft amendments. During the August meeting, participants discussed the effect of the presumption and asked BTC staff whether the new presumption might have some unintended effects, such as:

- Making it more likely for a person to be held personally liable for sales tax liabilities owed by its mobile food vending business under RTC section 6829;
- Making it more likely for a mobile food vendor to receive the 40 percent penalty imposed under RTC section 6597; and
- Potentially restricting mobile food vendors' participation in the Board's Offers in Compromise Program under RTC section 7093.6.

BTC staff determined that the potential effect of the new presumption was limited, particularly because the presumption may be overcome. BTC staff also determined that the instances in which a retailer would need to overcome the presumption were uncommon.

With respect to personal liability imposed under RTC section 6829, as stated above, the presumption can be overcome. Further, collection of tax reimbursement is only one of the four required elements. The Board cannot hold a responsible person liable for sales tax reimbursement the business collected, unless the Board can also demonstrate that the person willfully failed to pay the tax or cause it to be paid to the Board. Consequently, the presumption alone is unlikely to have a significant impact on responsible person liability. Similarly, the presumption does not increase the likelihood that the 40 percent penalty imposed under RTC section 6597 will apply. For the penalty to apply, in addition to evidence that taxpayer charged or collected tax reimbursement, it must also be shown by "clear and convincing" evidence that the deficiency was the result of an intent to evade the tax. With respect to the Offers in Compromise program, the operation of the presumption would not preclude a taxpayer from participating in the program. For an ongoing business to participate in the program, it need only provide evidence to rebut the presumption that tax reimbursement was collected. Therefore, BTC staff determined that it was not necessary to draft and suggest further amendments to Regulation 1603 to address the application of RTC sections 6597, 6829, and 7093.6, at this time.

Following the interested parties meeting, other Board staff recommended that new subdivision (u) be revised to remove the language indicating that the new presumption will be "[e]ffective July 1, 2014" and instead include new language stating that it will apply to mobile food vendors' "[s]ales made on or after July 1, 2014." BTC staff agreed that the changes would make the application of the new presumption more clear and revised the draft amendments to the regulation, accordingly.

November 19, 2013, BTC Meeting

Subsequently, BTC staff prepared Formal Issue Paper 13-009 and distributed it to the Board Members for consideration at the Board's November 19, 2013, BTC meeting. Formal Issue Paper 13-009 recommended that the Board propose to add subdivision (u) to Regulation 1603 to define the term "mobile food vendors," and provide that, for sales made on and after July 1, 2014, unless a separate amount for tax reimbursement is added to the price of meals, a mobile food vendors' sales of taxable items are presumed to be made on a tax included basis. The formal issue paper also recommended that new subdivision (u) provide that this presumption does not apply when a mobile food vendor is making sales as a "caterer" as defined in subdivision (h)(1) of Regulation 1603.

At the conclusion of the Board's discussion of Formal Issue Paper 13-009 during the November 19, 2013, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1603 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1603 are reasonably necessary to have the effect and accomplish the specific purpose of addressing the mobile food vendors' signage issue by permitting mobile food vendors to make sales on a tax included basis even in the absence of signage expressly providing that their sales are made on a tax-included basis.

The Board anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit taxpayers, Board staff, and the Board by providing regulatory provisions consistent with industry practice and the understanding of mobile food vendors and their customers that mobile food vendors' sales are made on a tax-included basis.

In addition, the Board has determined that the proposed amendments are not mandated by federal law or regulations, and there are no federal regulations or statutes that are identical to Regulation 1603 or the proposed amendments to Regulation 1603.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 13-009, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its November 19, 2013, BTC meeting in deciding to propose the amendments to Regulation 1603 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1603 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1603 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1603 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2,
SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY
GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The sales tax reimbursement may be shown as a separately stated amount added to the stated sales price of the tangible personal property or the sales tax reimbursement may be included in the total lump-sum price charged for tangible personal property. As previously explained, under Civil Code section 1656.1, it shall be presumed that the parties agreed to the addition of sales tax reimbursement to the sales price of tangible personal property if the retailer posts in his or her premises in a location visible to purchasers, or includes on a price tag or in an advertisement or other printed material directed to purchasers, a notice to the effect that reimbursement for sales tax will be added to the sales price of all items or certain items, whichever is applicable. Regulation 1700 contains a general presumption that taxable tangible personal property is sold at a price which includes tax reimbursement if the retailer posts a specified sign to that effect.

As previously explained, mobile food vendors do not generally have point of sale systems to calculate tax on individual transactions. Additionally, they often make sales in multiple tax districts in a given day and, as a result, their sales are often subject to varying tax rates. Therefore, it is common practice in the mobile food industry for mobile food vendors to make sales on a tax-included basis. It is common practice in the mobile food industry for mobile food vendors to round their tax-included prices to the nearest quarter or dollar. And, mobile food vendors generally intend for the prices charged for the meals that they sell to include all applicable taxes, and their customers expect that amounts for sales tax reimbursement are included in prices charged by the mobile food vendors.

Also, as previously explained, while the mobile food industry practice is for mobile food vendors to include tax reimbursement in their menu prices, during recent audits, Board staff found that many mobile food vendors did not have a sign posted stating that tax was included in their menu prices.

The amendments to Regulation 1603 generally describe “mobile food vendors” and provide that for sales made by mobile food vendors on or after July 1, 2014, it is presumed that the sales are made on a tax-included basis, unless the vendor adds a separate amount for tax reimbursement to the price charged to its customer. The proposed amendments are intended to make Regulation 1603 consistent with the mobile food industry’s practice, which is to include tax reimbursement in menu prices, and there is nothing in the proposed amendments to Regulation 1603 that would significantly change how mobile food vendors and their customers would generally behave in the absence of the proposed amendments.

In addition, the amendments to Regulation 1603 do not require any further action by mobile food vendors or their customers in order for the presumption to apply, and the proposed amendments permit, but do not require mobile food vendors to rebut the presumption by adding a separate amount for sales tax reimbursement to the sale price of the items they sale. Therefore, the proposed amendments do not impose any costs on any persons, including mobile food vending businesses. The Board estimates that the proposed amendments will not have a measurable economic impact on individuals and business. And, the Board has determined that the proposed amendments to Regulation 1603 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California

business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period.

Further, based on these facts and all of the information in the rulemaking file, the Board has also determined that the adoption of the proposed amendments to Regulation 1603 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, Regulation 1603 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1603 will not affect the benefits of Regulation 1603 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1603 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1603 may affect small businesses.